



# **NAVAL POSTGRADUATE SCHOOL**

**MONTEREY, CALIFORNIA**

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## **MBA PROFESSIONAL REPORT**

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**Federal Financial Reform.  
Policy Formulation to Implementation: Research into  
Relationships between the President's Management Agenda  
Scorecard, Federal Audited Financial Statements, and the GAO  
High Risk List**

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**By: Andrew W. Lind  
December 2005**

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SCORECARD, FEDERAL AUDITED FINANCIAL STATEMENTS, AND THE  
GAO HIGH RISK LIST**

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# **I. INTRODUCTION**

## **A. BACKGROUND**

Government financial reform was renewed with vigor through a series of Congressional laws in the 1990s. These laws injected interest and scrutiny into reform efforts and directed attempts to gain control over federal agency finance activities in the areas of accountability and performance. Leading the attempts was the Government Accountability Office (GAO). The GAO (formerly the General Accounting Office) was initially created out of the Budget and Impoundment Act of 1921 to provide for auditing responsibilities, accounting, and claims functions for the US Government.<sup>1</sup> Over time, due to changes in legislation and changing needs of Congress, the mission of the GAO has changed. This is best manifested in its recent name change from the General Accounting Office to the General Accountability Office. The GAO website now lists its objectives as four-fold<sup>2</sup>:

- Evaluating how well government policies and programs are working;
- Auditing agency operations to determine whether federal funds are being spent efficiently, effectively, and appropriately;
- Investigating allegations of illegal and improper activities; and
- Issuing legal decisions and opinions

The goal of the GAO, in short, is to make federal government agencies more effective. The thrust of their work involves evaluating and offering opinions on ways to improve government functioning. The GAO High Risk List is one of the many ways that the GAO attempts to fulfill this function. High Risk List identified items specifically target those organizations that exhibit substandard

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<sup>1</sup> GAO History [web page]. Available at: <http://www.gao.gov/about/history.html> Accessed 12 November 2005.

<sup>2</sup> Ibid.

financial and managerial performance with the intent of directing improvement toward those efforts. The work and functioning of this report will be studied in further detail with a focus on how it interacts with other executive agency financial management systems.

A second major effort involved the Office of Management and Budget (OMB) oversight of agency audited financial statements. The Office of Management and Budget was created in 1970 from the old Bureau of Budget, which had been originally established by the Budget and Impoundment Act of 1921. The agency is principally chartered to be the executive agency with overall responsibility for preparing the President's budget and overseeing financial operations and execution among all federal agencies. By virtue of its function in executive financial oversight, OMB was tasked with the responsibility of monitoring financial accountability requirements laid in place by the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. The principal output of this requirement is audited financial statements for federal agencies. With OMB as the principal guiding agent, federal agencies have met with various levels of success and failure in obtaining unqualified opinions in their financial statements.

The latest oversight system is the President's Management Agenda (PMA) Agency Scorecard. Initiated in FY2002, this system is intended to measure agency performance and results as identified in standards set by the current administration. The scorecard finds its roots in the Government Performance Results Act of 1993 and focuses on achieving performance and results-oriented management for government. The scorecard is also guided by OMB as the President's executive agency for financial operations and execution.

These three measures of federal agency financial accountability and performance, while separate, should all be related in the context of measuring agencies' overall financial success. Comparing their stated goals and an analysis of interrelationships and trends between data will help provide a framework for addressing financial reform success within current defined federal guidelines.



## **B. SCOPE AND OBJECTIVE**

The overall objective will be to provide an analysis of trends and interrelationships between the three major federal financial oversight systems – the PMA Scorecard, Audited Federal Financial Statements, and the GAO High Risk List. At a high level, it will provide information on which agencies tend toward success or failure with respect to these measures. An analysis of the interrelationships between the three systems will identify any impact or overlap the systems may have on one another. It will show which system trends signal success among other systems. For example, it may help identify whether accountability (as measured by unqualified opinion on financial statements) translates to performance success on the PMA Scorecard.

The research is undertaken with an exploratory focus. An overview of the three systems is presented with a focus on their intents and purposes. Through this overall systems look, relationships are established that may dictate links between agency success and system linkages. A detailed look into each specific agency is not provided in this report. Rather, the focus is on the overall relationships of agencies within the discussed systems. True causal links are difficult to propose without the benefit of further research into the individual agencies discussed. As such, the data and trends are presented at a top level with the intent of revealing relationships and providing focus for further research.

Data findings in the professional report will help to identify trends between three federal measurements of financial accountability and performance. The trends will potentially provide signaling points that identify those organizations on the verge of success as measured by the systems. The proper identification of these relationships could help agencies better target reform initiatives and/or provide informed knowledge of those specific items that drive success.

## **C. METHODOLOGY**

The methodology of work begins with the identification of the problem. In the case of federal agencies, multiple measures exist which define the success

or failure of financial management within the agency. While all of these measures provide worth in the improvement of federal financial management, the interrelationships and value-added aspects of these measures must be addressed.

Numerous frameworks address financial accountability and performance in organizations. While most models address financial accountability in profit-motivated organizations, they do provide for an informed foundation on federal financial management techniques. While the application of these frameworks to federal agencies always proves more difficult, the case is made for the importance and relevance of these criteria in federal financial management. These cases will be presented for the three financial systems discussed.

Raw data for agency comparisons will be obtained through relevant agency reports. The data will be ordered and reviewed as both a function of their relationships between systems and individual system changes over time. As the data is ordinal in nature, nonparametric statistical tests will be applied. A starting point for data analysis will be based around three relationships:

- Analysis of PMA Scorecard and audited financial statements across their respective operating timeframes. The goal will be to look for agencies that exhibit trends that identify success. Additional comparisons will be made between scorecard “implementation progress” data to determine whether it leads to financial performance success in the scorecard.
- The PMA Scorecard will be analyzed as a function of accountability as measured by audited financial statement data. The outcome is to determine whether unqualified opinions on audited financial statements are a good predictor of performance on the PMA Scorecard.
- The impact of GAO High Risk list on audited financial statements and the PMA Scorecard will be addressed. It will look at whether GAO opinions have had an impact on agency success in those systems.

The GAO list comparison will account for agencies that are on the list and those who have improved and been removed from the list.

#### **D. ORGANIZATION**

The project begins in Section II with a look at the history of federal financial reform. Historical reform initiatives over the last century are covered in brief followed by a specific focus on recent reform initiatives. Additional emphasis has been placed on recent initiatives as direct relationship may be drawn between the specified legislation and the requirement for audited financial statements and development of the PMA Scorecard. The legislation discussed is by no means a complete list of financial reform and is not intended as such. Throughout, an effort has been made to pare down the extraneous information and focus on those initiatives that have had a major impact on the three financial systems discussed.

Section III provides an overview of the three federal financial oversight programs compared – The PMA Scorecard, Audited Federal Financial Statements, and the GAO High Risk List. The section will cover the objectives of the system, how the agency information is derived, agency grading or scoring criteria, and what accomplishments have been ascribed to the systems to date. The basic data for system analysis is also provided.

The data and system analysis is presented in Section IV. A description of data collection methods and statistical methodology is discussed. As the data is ordinal in nature, standard parametric statistical approaches (standard deviation, variance) need to be avoided in most cases. Non-parametric techniques are provided to describe the correlation of data between financial systems. The data is first analyzed by describing data trends within separate systems that are of value to further analysis. Financial system data is then analyzed to identify trends and provide a comparison between the systems.

Section V represents the culmination of the project and presents a summary of conclusions drawn from the data. Implications of the resultant data

are presented for the Department of Defense. In addition, as the project is exploratory by nature, Section V presents recommendations for further study and research.

## **II. FEDERAL FINANCIAL REFORM**

### **A. EARLY REFORM INITIATIVES**

Government financial reform is by no means a new topic. Congress has attempted to levy various controls on financial and budgetary spending in federal government agencies as early as the 1900's with the Budget and Accounting Act of 1921.<sup>3</sup> The trend continued throughout the century with the passing of legislation such as Public Law 84-863 (1956), the Congressional Budget and Impoundment Control Act of 1974, and the Federal Managers Financial Integrity Act of 1982. Though covering various topics, the legislation represented an overall trend toward greater executive branch control of budgeting and tighter scrutiny and accountability in its management.<sup>4</sup> While recent legislation has provided the foundation for many of the financial reform initiatives we see today, it is important to present a cursory review of the goals and impact of key financial reform legislation over the past century. The list provided is not inclusive of all reform initiatives throughout history, but focuses on those that have had a significant impact to the creation of the agencies and systems analyzed.

#### **1. Budget and Accounting Act of 1921**

The Budget and Accounting Act of 1921 was landmark legislation in terms of defining our current budgetary process. The Act provided for the creation of the Bureau of the Budget (now the Office of Management and Budget) and the General Accounting Office (now Governmental Accountability Office). These two organizations were created to be the centralized control points on financial management and budget for the executive and legislative branches,

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<sup>3</sup> Philip J. Candreva, ed. *Practical Financial Management*, 6th ed. (Monterey, CA: United States Naval Postgraduate School: 2004), 5.

<sup>4</sup> KnowNet: Federal Budget Execution [web page]. Updated 2 May 2005. Available at: <http://www.ogam2000.com/finance/budexecDR/LAI/ModuleI/stat.htm>. Accessed 13 June 2005.

respectively.<sup>5</sup> The Act also required the submission and consolidation of executive agency budget requests to the President through the Bureau of Budget. In an excerpt from the Congressional Committee of the Budget, the Budget and Accounting Act was developed in response to the belief in the need for a strong “centralized approach to financial policy and process” in both the executive and legislative branches of government.<sup>6</sup>

The legislation is important in many respects, not the least of which is the creation of OMB and the GAO. While both seem to be initially chartered as paper pushers, record keepers, and auditors, their role has expanded to that of central importance in financial reform. Through the GAO, Congress had created a watchdog group of sorts to monitor and report on executive agency financial execution and management practices. GAO has continued to provide ongoing evaluations of executive agency financial management, specifically with the High Risk Series. While OMB has always had a strong focus on government budget development and control, it has evolved in recent years to be the President’s organization in charge of evaluating the effectiveness and performance of federal agencies. The most recent incarnation of this management responsibility is through oversight of audited financial statements and the PMA Scorecard.

## **2. The Budget and Accounting Procedures Act of 1950 and Public Law 84-863**

In addition to amendments to the anti-deficiency act and apportionment requirements, the Budget and Accounting Procedures Act had a significant effect on agency financial management as it provided congressional direction on establishing accounting systems and financial reporting. In addition, the Act makes GAO the accountable agency for establishing federal accounting and

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<sup>5</sup> DoD iCenter: Legislative Reform Initiatives [web page]. Available at: <http://www.dod.mil/comptroller/icenter/inforef/legislatemain.htm>. Accessed 2 November 2005.

<sup>6</sup> Committee on the Budget, United States Senate, *The Congressional Budget Process: An Explanation*. (Washington D.C.: Government Printing Office, 1998): 7.

auditing standards.<sup>7</sup> These two facets of the Act provide the basics for the early development of financial management and control systems and standards.

Public Law 84-863 (1956) was enacted “to take the necessary action to achieve: 1) consistency in accounting and budget classifications; 2) synchronization among accounting, budgeting, and organizational structure; and 3) support of budget justification by information on performance and program costs.”<sup>8</sup> It gave the President the ability to provide Congress with budget information on a cost basis as well as the inclusion of information on financial performance and accomplishments. These two acts have defined executive and legislative branch powers and responsibilities in financial reporting and control. They are valuable in that they are the basic tenets of current accountability and control measures in the federal government.

### **3. Congressional Budget and Impoundment Act of 1974**

Beginning with the Budget and Accounting Act of 1921, executive control over budget and spending was preeminent. Candreva argues that since the 1921 Act, executive spending grew as congressional committees did little but provide a check on what the president was submitting.<sup>9</sup> Concerned over rising spending with only little oversight through the greater part of the century (as well as specific impoundment concerns ascribed to President Nixon),<sup>10</sup> Congress passed the Congressional Budget and Impoundment Act of 1974 to wrest control of federal spending back to where it constitutionally belonged – Congress.

The Congressional Budget and Impoundment Act had four central aspects: establishment of the Congressional Budget Office; limits on presidential impoundment powers, change of the fiscal year (from a July-June cycle to an

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<sup>7</sup> U.S. General Accounting Office, *The Chief Financial Officers Act: A Mandate for Federal Financial Management Reform* (Washington, D.C.: USGAO, 1991), 25.

<sup>8</sup> Deborah McClain, “The Nature of Financial Management in the Federal Government.” (1999): 31.

<sup>9</sup> Candreva, 6.

<sup>10</sup> Ibid.

October-September cycle), and a change to the congressional budget process.<sup>11</sup> The Congressional Budget Office was established to provide congressional committees with the information they need to analyze the budget and other appropriations bills.<sup>12</sup> Specific changes to the process included the creation of budget committees and a budget reconciliation to set revenue and spending limits.<sup>13</sup> The Act also limited the President's impoundment ability, effectively requiring him to spend the money that Congress had signed into law.

The summation of these legislative changes helped to establish a specific process through which Congress could review and address the President's budget. While these changes are not specifically related to any of the analyzed financial systems, they do represent the landmark legislation in reestablishing congressional control and influence over federal financial management. By regaining control on budgetary matters, it permitted Congressional insight into financial processes and the eventual passage of the major reform initiatives of the 1990s.

#### **4. Federal Managers Financial Integrity Act of 1982**

The FMFIA of 1982 was passed by Congress to "require ongoing evaluations and reports of the adequacy of the systems of internal accounting and administrative control of each executive agency."<sup>14</sup> The Act modifies the Budget and Accounting Act of 1950 and requires individual agency heads to establish accounting and oversight controls for the safeguarding of government assets in accordance with GAO-developed standards.<sup>15</sup> It also directs OMB to create an evaluation system to monitor these controls and report to Congress the agencies' ability to meet these controls on a yearly basis.<sup>16</sup> The Federal

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<sup>11</sup> U.S. Public Law 93-344, 93rd Cong. (12 July 1974).

<sup>12</sup> Ibid.

<sup>13</sup> Committee on the Budget, 8.

<sup>14</sup> U.S. Public Law 97-255, 97th Cong. (8 September 1982).

<sup>15</sup> Ibid, Sec 2.

<sup>16</sup> Ibid, Sec 2.



Managers Financial Integrity Act essentially created the first report on the ability of financial systems to meet agency management needs and ensure public confidence in the execution of funds.

However there have been questions about whether the FMFIA actually achieved any of its intended purposes. A GAO report recognized that while many agencies reported material weaknesses in their financial systems for years, little appeared to have been done about it.<sup>17</sup> Riso addresses many of the issues related to underachievement of the FMFIA and reiterates the point that the Act has been only “marginally useful.”<sup>18</sup> It appears that while this was a first attempt to ensure ‘integrity’ in the financial management process, true change would have to wait until the reform initiative of the 1990s.

## **B. FINANCIAL REFORM INITIATIVES - 1990S**

The earlier changes of the century, while important in setting the groundwork for federal budget development and guidelines, paled in comparison to federal accountability requirements enacted in the 1990s. Beginning with the Chief Financial Officers (CFO) Act in 1990, Congress launched a series of laws designed to “gain control of federal finances.”<sup>19</sup> These laws were broad in their scope and intent on federal financial reform. The CFO Act, Government Performance and Results Act (GPRA) of 1993, Government Management Reform Act (GMRA) of 1994, and the Federal Financial Management Improvement Act (FFMIA) of 1996 vastly altered the landscape of federal fiscal accountability and control. These acts set forth clear goals and objectives in reforming government financial management consistent with standard business practices. These efforts included requirements for consolidated and audited

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<sup>17</sup> U.S. General Accounting Office, *The Chief Financial Officers Act: A Mandate for Federal Financial Management Reform*, 11.

<sup>18</sup> Gerald R. Riso, “Reviving management controls” *Government Executive* 28 Iss. 5 (May 1996): 67.

<sup>19</sup> Anonymous, “A Brief History of Reform.” *Government Executive* 30 no. 6 (June 1998): 44.

financial statements, standards for reporting program performance, and standardized accounting systems and measures.<sup>20</sup>

## **1. Chief Financial Officers Act of 1990**

The CFO Act is the main initiating document of federal financial reform in the 1990s. Its stated purpose is to “to improve the general and financial management of the Federal Government.”<sup>21</sup> The CFO Act does this in three ways:

- By bringing effective financial management to government;
- The improvement of systems of accounting, financial management, and internal control;
- The production of reliable and timely financial reports.<sup>22</sup>

The law requires the centralization of management functions under an agency Chief Financial Officer, the completion of annual financial statements, and the modernization of financial systems.<sup>23</sup>

Few would argue with the idea that this legislation acted as a catalyst for federal agency financial reform. The GAO called the CFO Act the “most comprehensive and far-reaching financial management improvement legislation since the Budget and Accounting Procedures Act of 1950 was passed over 40 years ago.”<sup>24</sup> Fourteen years later, Congress still appreciates the benefits of the CFO Act believing it “the basis for agency financial management.”<sup>25</sup> Scholars agree as well. Steinberg relates how the Act resulted in substantially improved

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<sup>20</sup> Sid Ewer, “Federal Government Accountability,” *The CPA Journal* 67 no. 3 (March 1997)

<sup>21</sup> U.S. Public Law 101-576, 101st Cong., 2d Sess. (23 January 1990).

<sup>22</sup> U.S. Public Law 101-576, 101st Cong., 2d Sess. (23 January 1990), Title I, Section 102.

<sup>23</sup> Andrew West and David Clarke, “Government as Business,” *The Government Accountants Journal* 45, no. 1 (Spring 1996): 24.

<sup>24</sup> U.S. General Accounting Office, *The Chief Financial Officers Act: A Mandate for Federal Financial Management Reform* (Washington, D.C.: USGAO, 1991), 1.

<sup>25</sup> U.S. House Committee on Government Reform, *Department of Homeland Security Financial Accountability Act*, 108<sup>th</sup> Cong., 2<sup>nd</sup> Sess., 9 June 2004, 4.

and consolidated agency financial systems and major policy and standards revisions for federal agencies.<sup>26</sup> West and Clarke point to universal support for the CFO Act principles by the likes of financial managers, inspectors, and auditors.<sup>27</sup> In addition, Gross points to synergies in financial practices, increase in accountability as measured by audits, and the movement from problem identification to solutions for agency financial issues as great benefits of the CFO Act.<sup>28</sup> The CFO Act's historical significance on federal financial reform is clear.

This passage of this law had important ramifications on government financial accountability but it was a pilot program for audited financial statements as it applied to only a few agencies. The expansion of the audited financial statement requirement through the GMRA in 1994 was a major step forward. The CFO Act has been one piece of legislation that has been influential in the progress of financial reform and is important in that it is directly linked to the creation of audited financial statements and reform concepts as a whole.

## **2. Government Performance Results Act of 1993**

While the CFO and GMRA represent the driving force behind government financial accountability, two other acts had significant impact in the 1990s - the GPRA and the FFMIA. The first of these acts involves implementing managerial accounting type initiatives in federal government. Congress considered federal managers and government decision makers handicapped by waste, inefficiency, and lack of attention to results.<sup>29</sup> To combat these perceived weaknesses, the GPRA added requirements for internal management, performance measurement, and managing for results.<sup>30</sup> It represents a major shift from traditional execution functions to one focused on comparing results with the agency mission and

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<sup>26</sup> Harold Steinberg, "The CFO Act: A Look at Federal Accountability," *Journal of Accountancy* 181, no. 3 (March 1996): 55.

<sup>27</sup> West and Clarke, 20.

<sup>28</sup> Daniel Gross, "Baby Steps," *CFO* 12 no. 7 (July 1996): 28.

<sup>29</sup> U.S. Public Law 103-62, 103rd Cong. (5 January 1993), Section 2.

<sup>30</sup> Ibid.

desired outcomes. As Breul puts it, the act “articulates what they [agencies] are trying to accomplish, how they will accomplish it, and how Congress and the public will know whether they are succeeding.”<sup>31</sup>

The requirement of strategic planning and this emphasis on meeting results has led many to conclude, if only moderately, that the GPRA was a success. Breul considers the GRPA a success in developing and implementing a performance management framework in government.<sup>32</sup> The President’s Management Agenda and the use of the agency scorecard is an extension of the principles of the GPRA. David agrees that the PMA has demonstrated that the administration is determined to see results in management government resources.<sup>33</sup>

### **3. Government Management Reform Act of 1994**

The scope of initial reform efforts was expanded with the GMRA. While the Act was directed by Congress to “provide a more effective, efficient, and responsive government,”<sup>34</sup> the relevant thrust of the legislation was to expand CFO requirements to all 24 major federal agencies.<sup>35</sup> It additionally included a requirement for a single, auditable consolidated federal financial statement.<sup>36</sup> The Act sets fiscal year 1996 as the first year for audited financial statements for all federal agencies. By expanding financial statement requirements to all agencies, the GMRA validates and reinforces CFO Act principles of financial accountability.

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<sup>31</sup> Jonathon Breul, “The Government Performance and Results Act – 10 Years Later,” *The Journal of Government Financial Management* 52 Iss. 1 (Spring 2003): 58.

<sup>32</sup> Breul, 63.

<sup>33</sup> Irwin T. David, “Financial Information for Program, Policy, and Operating Officials,” *The Journal of Government Financial Management* 51 no. 1 (Spring 2002): 14.

<sup>34</sup> U.S. Public Law 103-356, 103rd Cong., 2d sess. (25 January 1994),

<sup>35</sup> U.S. Public Law 103-356, 103rd Cong., 2d sess. (25 January 1994), Title IV, Section 405.

<sup>36</sup> Ibid.

#### **4. Federal Financial Management Improvement Act of 1996**

The FFMIA of 1996 echoed the earlier purposes of the CFO Act and GMRA and sought to strengthen reform efforts. The FFMIA added requirements for standards of accounting and systems across agencies and gave OMB an oversight role in agency financial reform.<sup>37</sup> The FFMIA makes development of these financial systems and standards a priority, with real consequences if the objectives are not met.<sup>38</sup> Despite early drafts of the bill, no budgetary consequences are involved. It does provide for inclusion into Congressional financial reports the names of agency officials responsible for failing systems and potential for their dismissal.<sup>39</sup> Some, notably Athanasaw, viewed the GMRA as an attempt by Congress to hurry the relatively slow implementation of the various legislative financial reform acts of the previous five years.<sup>40</sup>

#### **C. CONTINUED INITIATIVES**

These actions and improvements provide a start for discussing the work that is still to be done to fully implement the financial legislative reforms of the 1990s. Continued expansion of financial reforms is further evidence of the value of perceived benefits of the legislative reform initiatives of the 1990s.

##### **1. Accountability of Tax Dollars Act 2002**

The GAO made recommendations based on various reports for inclusion of other federal agencies in the CFO Act requirement for audited financial statements.<sup>41</sup> One study of CFO and GMRA act agencies showed that most have either achieved or expect to achieve significant benefit from financial

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<sup>37</sup> U.S. Public Law 104-208, 104th Cong. (30 September 1996), Section 802.

<sup>38</sup> Ewer, 26.

<sup>39</sup> Ibid, 27.

<sup>40</sup> Danny L. Athanasaw, "Financial Management Reform – Noble intentions, Audit Challenges," *The Armed Forces Comptroller* 43 no. 1 (Winter 1998): 18.

<sup>41</sup> U.S. General Accounting Office, Financial Management: Extending the Financial Statements Audit Requirement of the CFO Act to Additional Federal Agencies (Washington, D.C.: USGAO, 2002), 9-11.

statement audits.<sup>42</sup> These statements are further proof of the perceived benefits of ongoing federal financial reform. It appears that Congress agreed that CFO Act requirements would benefit all federal agencies. In 2002 Congress passed the Accountability of Tax Dollars Act, which extended the requirement for audited financial statements to all agencies with budget authority in excess of 25 million dollars.<sup>43</sup> The list of federal agencies covered by this act is exhaustive, with over 78 federal agencies affected. Agencies affected include the Federal Trade Commission, the Federal Communications Commission, and the National Transportation Safety Board, among others.

## **2. Office of Management and Budget Circular A-136**

The Office of Management and Budget (OMB) released OMB Circular A-136 in 2004 reinforcing its guidelines for submission of agency financial statements.<sup>44</sup> OMB A-136 additionally spelled out information regarding the preparation and submission of agency Performance and Accountability Reports (PAR). The PAR provides a combined summary of financial and performance results information as required by the GPRA and CFO Act.<sup>45</sup> These reports are an important step in supporting the PMA and in reinforcing support for audited financial statements.

## **D. FURTHER LITERATURE REVIEW**

Beyond the singular goals of individual legislative initiatives, many views have been provided as to the intent and purpose of the collective legislation. Brook, from a collection of congressional statements, posits the intent of audited financial statements (and, one can argue, the intent of all financial reform initiatives) as four-fold: 1) Improvement in financial systems and standards; 2) to provide reliable information for agency managerial decisions; 3) to provide

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<sup>42</sup> U.S. General Accounting Office, *Survey Results of Selected Non-CFO Act Agencies View on having Audited Financial Statements* (Washington, D.C.: USGAO, 2001), 2-3.

<sup>43</sup> U.S. Public Law 107-289, 107th Cong. (7 November 2002), Section 2.

<sup>44</sup> Office of Management and Budget, *Financial Reporting Requirements* (Washington D.C.: OMB, 2004).

<sup>45</sup> Office of Management and Budget, *Financial Reporting Requirements*, 1.

reliable information for government decision makers in program and resource allocation; and 4) stewardship.<sup>46</sup> This view on the purposes appears to be a comprehensive and mainstream view that many scholars corroborate. Longo and Steinberg<sup>47</sup> also make the case for stewardship and, by implication of incorporation of private sector financial practices, the improvement of financial systems and controls. Similar purposes are reiterated in works by Boerum<sup>48</sup> and the U.S. Governmental Accountability Office (GAO).<sup>49</sup>

One of the goals of the legislative reforms was the improvement of financial systems. West and Clarke<sup>50</sup> discuss early problems with federal agencies and the lack of integrated financial systems. In 1995, West and Clarke point to information that only 29% of systems were part of a single integrated system.<sup>51</sup> By 2003 we see that 20 of the 24 CFO and GMRA agencies (or 83%) have an integrated financial system.<sup>52</sup> While it is clear there is still work to be done, the literature supports a positive trend in accomplishing the goal of improved financial management systems in federal agencies.

Reliable information for both internal and external agency decision makers is a function of the accuracy and conformity of financial data available. Steinberg is one proponent and agrees that as more agencies prepare audited financial

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<sup>46</sup> Douglas Brook, *Audited Financial Statements: Getting and Sustaining Clean Opinions* (Arlington VA: The PricewaterhouseCoopers Endowment for the Business of Government, July 2001), 9.

<sup>47</sup> Ronald Longo and Harold Steinberg, "The Federal Governments First Audited Government-wide Financial Statements," *The Government Accountants Journal* 47, no. 2 (Summer 1998): 18.

<sup>48</sup> Ken Boerum, "Why are We Doing This New Accounting?" *The Armed Forces Comptroller* 49 no. 2 (Spring 2004): 23.

<sup>49</sup> U.S. Governmental Accountability Office, *Fiscal Year 2004 US Government Financial Statements: Sustained Improvement in Federal Financial Management Is Crucial to Addressing our Nation's Future Fiscal Challenges* (Washington, D.C.: USGAO, 2004), 2.

<sup>50</sup> Andrew West and David Clarke, "Government as Business," *The Government Accountants Journal* 45, no. 1 (Spring 1996): 23.

<sup>51</sup> *Ibid*, 23.

<sup>52</sup> U.S. General Accounting Office, *Financial Management Systems: Core Financial Systems at the 24 Chief Financial Officers Act Agencies* (Washington, D.C.: USGAO, 2003), 2.

statements, the value to decision makers will grow.<sup>53</sup> If an unqualified audit opinion signals accurate financial information we can see that the goal is close, but not fully successful. Of the 24 federal agencies, 18 have achieved and sustained an unqualified opinion for at least two years.<sup>54</sup> Further evidence of informational value to decision makers is discussed in Section IIIA.

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<sup>53</sup> Harold Steinberg, "The CFO Act: A Look at Federal Accountability," *Journal of Accountancy* 181, no. 3 (March 1996): 56.

<sup>54</sup> Reference Table 1



### **III. FINANCIAL MEASUREMENT SYSTEMS**

Various financial measurement systems exist for the federal government. The analysis in this paper focuses on three measurement systems – audited financial statements, the PMA Scorecard, and GAO High Risk Series. A brief overview of the objectives, content, and accomplishments of each system is provided. This background is important to understand the basic aspects of the systems and in analyzing their relationships to each other.

#### **A. FEDERAL AUDITED FINANCIAL STATEMENTS**

##### **1. Objectives and Purpose**

Financial statements are standardized formats used to report financial information to external decision makers.<sup>55</sup> The statements are designed to provide the decision maker information on whether the organization is “using their resources effectively and efficiently.”<sup>56</sup> For-profit companies prepare balance sheets, income statements, and cash flow statements to meet generally accepted accounting principles. While these formats don’t directly apply to government agencies, the theories behind them do. Specific formats are discussed in Section III.A.2, below.

Financial statement audits are performed to provide assurance that financial statement assertions adhere to generally accepted accounting principles.<sup>57</sup> These assertions are done for a variety of reasons. Most believe the beneficiaries of financial statement audits are solely creditors and potential investors. In fact, independent audits may be performed for additional reasons as well. Taylor and Glezen propose two other reasons for financial statement

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<sup>55</sup> Robert Ingram and Thomas Albright and Bruce Baldwin, *Financial Accounting: A Bridge to Decision Making*, 5<sup>th</sup> ed. (Ohio: Thomson South-Western, 2004), F129.

<sup>56</sup> Ibid, F143.

<sup>57</sup> Donald Taylor and William Glezen, *Auditing: An Assertions Approach*, 7<sup>th</sup> ed. (New York: John Wiley & Sons, Inc., 1997), 4.

audits: stewardship and motivation.<sup>58</sup> Summarized, audited financial statements provide stewardship through support to the belief that managers, as agents for a company's owners, are acting in accordance with their interests. Additionally, audited financial statements motivate managers to truthfully and diligently prepare statements as they know they will be audited.<sup>59</sup>

Government financial statement audits serve a similar purpose. The combined GAO and President's Council on Integrity and Efficiency (PCIE) Financial Audit Manual state the "overall purposes of performing financial statement audits of federal entities include providing decision makers (financial statement users) with assurance as to whether the financial statements are reliable, internal control is effective, and laws and regulations are complied with."<sup>60</sup> This is done through enforcing Federal Accounting Standards Advisory Board (FASAB) developed generally accepted accounting principles on financial statements. The mission of the FASAB is to "promulgate federal accounting standards after considering the financial and budgetary information needs of citizens, congressional oversight groups, executive agencies, and the needs of other users of federal financial information."<sup>61</sup> As the standard-setting body for federal government accounting principles, agency financial statements must conform to their guidance.

It is easy to see that the objectives of federal financial statement audits as described by the GAO meet some of the same needs as for-profit organizations. It meets stewardship needs of the public and Congress and provides valuable motivation to improve and sustain financial accountability. Creditor and investor needs aren't apparent in the strictest interpretation of audited financial statement goals. However, tax-paying citizens and businesses can be seen as analogous

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<sup>58</sup> Taylor and Glezen, 9-10.

<sup>59</sup> Ibid, 10.

<sup>60</sup> U.S. Governmental Accountability Office, *Financial Audit Manual* Vol 1, (Washington, D.C.: USGAO, 2004), 100-1

entities for creditors and investors of the federal government. While statements differ in content from for-profit companies, they serve the same purpose.

## **2. Content**

Financial statements prepared by federal government agency contain standard statements. The main statements are the balance sheet, statement of net cost, and changes in net position. These three statements, for the most part, perform the function of reporting the U.S. Government financial position and operations.

The balance sheet serves a similar purpose as in for-profit accounting. It describes the summation of agency assets and liabilities. The consolidated statements of net cost summarize the departments operating costs. It is intended to provide, in one report, the cost of all operations of the federal agency. The statement of changes in net position and net cost might be seen as a proxy for the standard income statement. As the federal government is not in the business of making money, revenues in a traditional sense are replaced by taxes and other federal duties. It also presents the outflow of expenses that each agency generates in the fulfillment of its services and mission. These statements, along with the systems and methods used to prepare the statements, are the subject of audits.

The overall objective of the audit report is to present an opinion on financial statement presentation in accordance with generally accepted accounting principles. There are four types of opinions that may be issued: unqualified, qualified, disclaimer, or adverse. Each opinion represents a differing degree of conformity to generally accepted accounting principles and are summarized below from Taylor and Glezen.<sup>62</sup>

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<sup>61</sup> *Federal Accounting Standards Advisory Board* [web page], Available at: <http://www.fasab.gov/>. Accessed 18 November 2005.

<sup>62</sup> Taylor and Glezen, 34-35.

- Unqualified – statements are presented fairly in accordance with generally accepted accounting principles.
- Qualified – except for matters pertaining to the qualification, statements are presented fairly in accordance with generally accepted accounting principles.
- Disclaimer – auditor cannot express an opinion. Typically due to the auditor not being able to obtain necessary information to make an opinion.
- Adverse – financial statements represent a severe departure from generally accepted accounting principles.

The information used and analyzed for comparisons in this study will be at the audit opinion level. The opinion conveys the reliability and integrity of financial statements, but makes no performance judgment. It may be thought of as representing the accountability of all funds entrusted to and spent by each agency. A summary of opinions for analyzed agencies is presented in Table 1.

Agency	1996	1997	1998	1999	2000	2001	2002	2003	2004
DOC	D	D	D	U	U	U	U	U	U
DOD	D	D	D	D	D	D	D	D	D
DOE	U	U	Q	U	U	U	U	U	U
DOI	Q	U	U	U	U	U	U	U	U
DOJ	D	D	D	Q	Q	U	U	U	D
DOL	Q	U	U	U	U	U	U	U	U
DOT	D	D	D	U	Q	U	U	U	U
EDUCATION	D	U	D	Q	Q	Q	U	U	U
EPA	Q	U	U	Q	U	U	U	U	U
GSA	U	U	U	U	U	U	U	U	U
HHS	D	Q	Q	U	U	U	U	U	U
HUD	Q	Q	U	D	U	U	U	U	D
NASA	U	U	U	U	U	D	U	D	D
NRC	U	U	U	U	U	U	U	U	U
NSF	Q	Q	U	U	U	U	U	U	U
OPM	D	D	D	D	U	U	U	U	U
SBA	U	U	U	U	U	U	D	D	Q
SSA	U	U	U	U	U	U	U	U	U
STATE	Q	U	U	U	U	U	U	U	U
TREASURY	D	Q	Q	Q	U	U	U	U	U
USAID	D	D	D	D	D	D	Q	U	U
USDA	D	D	D	D	D	D	U	U	U
VA	Q	Q	Q	U	U	U	U	U	U

**Legend**  
U = Unqualified  
Q = Qualified  
D = Disclaimer

Table 1. Audited Financial Statement Results<sup>63</sup>

Source: Author created from 1999 – 2004 Financial Reports of the U.S. Government and Brook, “Business Style Financial Statements Under the CFO Act.”

### 3. Accomplishments

Most federal agencies have had 15 years to implement the requirements of the CFO Act and almost 10 years for other legislative financial reforms. The impact of these reforms on how government does business is immense. The effort entailed in getting an unqualified audit opinion on statements has been a major part of that undertaking. In 1990, only three agencies were audited and none received an unqualified opinion.<sup>64</sup> Gross reports that in 1996, six years

<sup>63</sup> While the Department of Homeland Security (DHS) and the Federal Emergency Management Agency (FEMA) have had or are required to have financial statements, they have been removed for purposes of comparison due to their consolidation.

<sup>64</sup> Daniel Gross, “Baby Steps,” *CFO* 12 no. 7 (July 1996): 28.

after the CFO Act and two years after the GMRA extended the requirement to 24 federal agencies, only 7 agencies received a clean opinion.<sup>65</sup> Longo provides a comparison to the 2004 audit results which show that 17 agencies received an unqualified opinion.<sup>66</sup> These accomplishments show a good trend toward financial accountability (timely, reliable information) in federal agencies that was lacking prior to 1990.

Equally important to receiving an unqualified opinion is the effect it has on financial systems. While many agree on the purposes and goals of financial statement audits, they are important only if they actually provide value to the government. A GAO survey of Non-CFO Act agencies showed that all agencies that did complete an audit received a “significant” benefit from the audit. The reported benefits met were those described by the general goals of financial reform legislation.<sup>67</sup> West and Clarke cite a Coopers and Lybrand LLP survey to government financial managers in which most agree that there is great value in completing financial reforms and accomplishing financial statements.<sup>68</sup> Their survey further states that “the primary value of financial statements... has not so much been the documents themselves, but instead the process of developing them.”<sup>69</sup> There are great benefits to creating standardized financial statements than just having the validated information itself. Longo and Steinberg discuss this key element further by describing a benefit of the financial audit process as an understanding of the systems, controls, and tasks in the process.<sup>70</sup>

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<sup>65</sup> Ibid, 27.

<sup>66</sup> Ronald Longo, “Accelerated Financial Reporting in the Federal Government – How Did It Go?” *The Journal of Government Financial Management* 54 no. 1 (Spring 2005): 33.

<sup>67</sup> U.S. GAO, Financial Management: Extending the Financial Statements Audit Requirement, 5-6.

<sup>68</sup> Andrew West and David Clarke, “Government as Business,” *The Government Accountants Journal* 45, no. 1 (Spring 1996): 2.

<sup>69</sup> Ibid, 2.

<sup>70</sup> Ronald Longo and Harold Steinberg, “The Federal Governments First Audited Governmentwide Financial Statements,” *The Government Accountants Journal* 47, no. 2 (Summer 1998): 24.

In addition to providing a good history on the implementation of the major financial reform acts of the 1990s, Ewer discusses the value of standard government financial statements by providing an illustrative reference to private sector companies.<sup>71</sup> Similar references to the value of government/private sector financial statements are provided by Chapin.<sup>72</sup> These benefits include standard private sector accounting benefits such as revenue, liability, and asset recognition and accountability. One could almost assume that the value of standardized reports and statements would be an intuitive benefit for the government. However, it took 200 years before the U.S. government took steps to implement such ideas, so their value in this discussion shouldn't be discounted.

Moving beyond value in a theoretical or general sense, examples can be identified of dollars saved due to the financial reforms resulting from audited financial statements. Due to the development of audited financial statements, the Department of Housing and Urban Development has been able to pinpoint violations and has recouped \$75M in costs.<sup>73</sup> West and Clarke provide further information showing monetary savings due to audits on federal financial statements.<sup>74</sup> Tabulating realized savings in comparison to implementation costs would be an interesting further study.

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<sup>71</sup> Sid Ewer, "Federal Government Accountability," *The CPA Journal* 67 no. 3 (March 1997): 22.

<sup>72</sup> Donald Chapin. "U.S. General Accounting Office Perspective on Future Audit Issues," *The CPA Journal* 65 no. 1 (January 1995): 32-33.

<sup>73</sup> Katherine Peters, "Dollars & Sense," *Government Executive* 30 no. 6 (June 1998): 43.

<sup>74</sup> West and Clarke, 25-26.

## **B. GOVERNMENT ACCOUNTABILITY OFFICE HIGH RISK SERIES**

### **1. Objectives and Purpose**

Begun in 1990, the High Risk Series focuses the GAO audit and evaluation expertise to “identify federal programs and operations that are high risk, in some cases, due to their greater vulnerabilities to fraud, waste, abuse, and mismanagement.”<sup>75</sup> Since 1993, the GAO has updated the list every 2 years to coincide with new congressional sessions. The reports have a much broader focus than strictly financial management. Many of the risks evaluated by the GAO include efforts in agency contracting, transformation, taxes, and modernization initiatives, to name a few.

While the High Risk Series covers many areas, the specific focus on this report is on financial management. Originally designated as a high risk area for agencies in 1990, financial management has continued to be a problem through the 15 years of GAO evaluation. Most federal agencies have struggled to meet the mandates of reform legislation over the past 15 years. GAO does not include all of these agencies on its High Risk List, only those that exhibit extreme financial management challenges.

### **2. Content**

Each report covers two main functions: an update on the status of existing identified risks and adds new issues as needed. The report summarizes the problems associated with each agency that have drawn the attention of GAO evaluation. Organizations that have been audited and added to the high risk list have exhibited a much larger degree of failure in obtaining financial statement assurance and scorecard success.

The list of those agencies covered by the GAO High Risk Series for financial management is rather short. Figure 1 summarizes those agencies and includes the year they were first added to the GAO list, and the year removed if

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<sup>75</sup> U.S. Governmental Accountability Office, *High Risk Series: An Update* (Washington, D.C.: USGAO, 2003), 3.



appropriate. The GAO high risk designation is usually conferred on sub-agencies of the 24 CFO Act agencies. In the case where this happens, the responsible CFO Act agency has been listed for purposes of comparison between the analyzed financial systems.

Responsible Agency	GAO Identified Organization	Year Added	Year Removed
DOD	DOD	1995	
USDA	Forest Service	1999	2005
DOT	FAA	1999	2005
Treasury	IRS	1990	
Treasury	Customs Service	1991	1999

Figure 1. GAO High Risk Financial Management Issues<sup>76</sup>

Source: Author created from U.S. GAO, *High Risk Series* 2005

### 3. Accomplishments

The GAO has provided audit and evaluation service to federal agencies since its inception. Therefore, it is no surprise that their influence on federal agencies included in their high risk list is substantial. A look at the timeline of agency concerns covered by the high risk list proves this point.

GAO completed its 1990 report by marking 14 agency concerns as high risk. While there has been significant additions over the years (27 have been added), there has also been 16 areas removed.<sup>77</sup> Given the length of time and scope of effort required to fix these significant high risk areas, it represents a significant achievement. The actions generated from these reports make it clear that federal agencies have taken the GAO High Risk List seriously.

## C. PRESIDENT'S MANAGEMENT AGENDA SCORECARD

### 1. Objectives and Purpose

According the GAO, the PMA brings forward major management challenges for federal agencies and sets forth the importance of performance

<sup>76</sup> Customs Service was part of the Treasury Department during the period analyzed

<sup>77</sup> U.S. Governmental Accountability Office, *High Risk Series: An Update* (Washington, D.C.: USGAO, 2005), 3.

results.<sup>78</sup> The President and OMB created the PMA to address perceived performance and cost inefficiency problems within the federal government. While achieving an unqualified opinion on audited financial statements is important, the current administration thinks that it should be a given.<sup>79</sup> The PMA was created to move beyond that. Its goal is reform, and a focus on improving the performance and management of government.<sup>80</sup> The President has initially focused on five government-wide areas of reform and various additional agency specific challenges. These government-wide areas were selected as the problems were “generally agreed to be serious,” and all reflected the desire of the President to achieve near-term, measurable results.<sup>81</sup>

Of the five government-wide challenge areas, one specifically applies and will be used in this systems analysis. That government-wide focus area is titled improving financial performance. OMB states that the objective of the improved financial performance initiative is “for agencies to have accurate and timely financial information to manage cost and achieve efficiencies.”<sup>82</sup> OMB PMA guidance states many reasons for the need to focus on improving financial performance and they mirror the impetus behind overall financial reform in many respects. OMB sites erroneous payments, audit opinion difficulties, timely reporting, and material weaknesses as a few.<sup>83</sup>

## **2. Content**

The PMA Scorecard was designed to measure five distinct areas where government improvement was needed. These areas are the strategic

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<sup>78</sup> U.S. Governmental Accountability Office, *Management Reform: Assessing the President's Management Reform Agenda* (Washington, D.C.: USGAO, 2005), 2.

<sup>79</sup> Executive Office of the President, Office of Management and Budget, *Federal Financial Management Report 2004* (Washington D.C.: Government Printing Office, 2004): 1.

<sup>80</sup> Executive Office of the President, Office of Management and Budget, *The President's Management Agenda* (Washington D.C.: Government Printing Office, 2001): 1.

<sup>81</sup> Executive Office of the President, *The President's Management Agenda*, 4.

<sup>82</sup> Office of Management and Budget, *Achieving Green in Financial Performance* (Washington D.C.: Government Printing Office, 2005): 1.

<sup>83</sup> Executive Office of the President, *The President's Management Agenda*, 19-20.

management of human capital, budget and performance integration, competitive sourcing, expanded electronic government, and improved financial performance. For purposes of analysis and system comparison, the focus is on improved financial performance.

The scorecard is presented in a stoplight format. For the overall financial performance results, the ratings are based on the demonstrated ability of the agency to meet the measures of success as defined in Figure 2 and above. A rating of green means the agency is fully successful in meeting all desired performance standards. A rating of yellow reflects that the organization is somewhat successful and meets performance standards listed under the yellow column in Figure 2. An organization is unsatisfactory if the rating is red. This means that the agency has been unsuccessful in meeting financial performance standards. Yearly scorecard ratings for each since the programs inception are provided in Table 2.

The government wide focus on improved system performance revolves around meeting the standards for audit opinions, financial statements, internal controls, and material weaknesses. OMB defines those standards required to achieve a yellow as ‘compliance’ standards – meaning that they are required to comply with legislation relating to accurate, timely, and reliable financial reports.<sup>84</sup> Achieving a scorecard rating of green means that the agency has met ‘results’ standards – defined by OMB Standards to mean the information is being used by managers to improve agency operations.<sup>85</sup> A list of standards required for each scorecard rating is summarized in Figure 2.

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<sup>84</sup> OMB, Achieving Green, 1.

<sup>85</sup> Ibid.




IMPROVED FINANCIAL PERFORMANCE		
		
<p>Agency:</p> <ul style="list-style-type: none"> <li>Meets all Yellow Standards for Success;</li> <li>Currently produces accurate and timely financial information that is used by management to inform decision-making and drive results in key areas of operations; <b>AND</b></li> <li>Is implementing a plan to continuously expand the scope of its routine data use to inform management decision-making in additional areas of operations.</li> </ul>	<p>Agency:</p> <ul style="list-style-type: none"> <li>Receives an unqualified audit opinion on its annual financial statements;</li> <li>Meets financial statement reporting deadlines;</li> <li>Reports in its audited annual financial statements that its systems are in compliance with the Federal Financial Management Improvement Act;</li> <li>Has no chronic or significant Anti-Deficiency Act Violations;</li> <li>Has no material auditor-reported internal control weaknesses;</li> <li>Has no material non-compliance with laws or regulations; <b>AND</b></li> <li>Has no material weaknesses or non-conformances reported under Section 2 and Section 4 of the Federal Managers' Financial Integrity Act that impact the agency's internal control over financial reporting or financial systems.</li> </ul>	<p>Agency:</p> <ul style="list-style-type: none"> <li>Receives an opinion other than unqualified on its annual financial statements;</li> <li>Does not meet financial reporting deadlines;</li> <li>Cannot report in its audited annual financial statements that its systems are in compliance with the Federal Financial Management Improvement Act;</li> <li>Commits chronic or significant Anti-Deficiency Act Violations;</li> <li>Has material auditor reported internal control weaknesses;</li> <li>Is in material non-compliance with laws or regulation; <b>OR</b></li> <li>Has material weaknesses or non-conformances reported under Section 2 and Section 4 of the Federal Managers' Financial Integrity Act that impact the agency's internal control over financial reporting or financial systems.</li> </ul>

Figure 2. PMA Financial Performance Standards

Source: *The Presidents Management Agenda: the Scorecard* [web page]

A rating of yellow or red does not necessarily mean that agency success is completely out of reach. OMB also provides a measure of agency progress toward achieving the standards as outlined. The President's Management Agenda website defines the progress measures thusly:

- Green: Implementation is proceeding according to plans agreed upon with the agencies;
- Yellow: Some slippage or other issues requiring adjustment by the agency in order to achieve the initiative objectives on a timely basis; and
- Red: Initiative in serious jeopardy. Unlikely to realize objectives absent significant management intervention.<sup>86</sup>

It is important to note that while the agency success is graded based on prescribed criteria, the progress scorecard is more of a subjective assessment by OMB based on predefined objectives. A yearly summary of agency scorecard progress is shown in Table 3.

<sup>86</sup> *The President's Management Agenda: The Scorecard* [web page]. Available at <http://www.whitehouse.gov/results/agenda/scorecard.html> Accessed 14 November 2005.

Agency	2002	2003	2004	2005
DOC	R	R	R	G
DOD	R	R	R	R
DOE	R	Y	G	G
DOI	R	R	R	R
DOJ	R	R	R	R
DOL	Y	Y	Y	G
DOT	R	R	R	R
EDUCATION	R	R	G	G
EPA	R	G	G	G
GSA	Y	Y	R	Y
HHS	R	R	R	R
HUD	R	R	R	R
NASA	R	R	R	R
NSF	G	G	G	G
OPM	R	Y	Y	R
SBA	R	R	R	R
SSA	Y	G	G	G
STATE	R	R	Y	G
TREASURY	R	R	R	R
USAID	R	R	R	R
USDA	R	R	R	R
VA	R	R	R	R

Table 2. PMA Scorecard Results<sup>87</sup>

Source: Author created from *The Presidents Management Agenda: the Scorecard* [web page]

<sup>87</sup> While the Department of Homeland Security (DHS) and the Federal Emergency Management Agency (FEMA) have had or are required to have financial statements, they have been removed for purposes of comparison due to their consolidation.

Agency	2002	2003	2004	2005
DOC	G	G	G	G
DOD	G	G	Y	R
DOE	G	G	G	Y
DOI	R	Y	Y	Y
DOJ	G	G	G	Y
DOL	G	G	G	G
DOT	G	G	G	G
EDUCATION	Y	G	G	G
EPA	Y	G	G	G
GSA	G	G	G	G
HHS	Y	G	G	G
HUD	Y	G	G	G
NASA	G	G	Y	Y
NSF	G	G	G	G
OPM	G	G	G	G
SBA	G	G	G	G
SSA	G	G	G	G
STATE	G	G	G	G
TREASURY	G	Y	Y	Y
USAID	Y	G	G	G
USDA	G	G	G	G
VA	Y	G	Y	Y

Table 3. PMA Scorecard Progress<sup>88</sup>

Source: Author created from *The Presidents Management Agenda: the Scorecard* [web page]

### 3. Accomplishments

In 2005, the GAO called the PMA fundamental to addressing 21st century management challenges.<sup>89</sup> While it is apparent that any attempt to address basic and systemic problems within the federal government would be considered important, the high level visibility and support for the PMA is what will make it successful. The 2004 Federal Financial Management Report, issued by the Office of Management and Budget, lists many accomplishments that have been

<sup>88</sup> While the Department of Homeland Security (DHS) and the Federal Emergency Management Agency (FEMA) have had or are required to have financial statements, they have been removed for purposes of comparison due to their consolidation.

<sup>89</sup> U.S. Governmental Accountability Office, *Management Reform: Assessing the President's Management Reform Agenda* (Washington, D.C.: USGAO, 2005), 2.

achieved to date as a result of the President's Management Agenda. Some of the notable achievements include the acceleration of financial reporting and agency-provided quarterly reports.<sup>90</sup> While understanding that this initiative is new, we are likely to see many more achievements in the years to come as agencies move beyond minimum requirements to managing for results. Over time, current agency plans for meeting PMA requirements will be effectively implemented in organizations. As a learning curve on PMA requirements is realized, these greater agency performance achievements will be met.

Many scholars believe the scorecard does promote agency improvement. Michael sees the scorecard as motivating force for reform in those areas tracked.<sup>91</sup> A panel of public administration experts backs up this assertion. Most are encouraged by the focus on financial management and believe that the PMA provides a disciplined approach for management reform.<sup>92</sup> Breul believes that the PMA is a valuable tool for the continued reform of federal financial management and suggests steps for further action and improvements.<sup>93</sup> David also agrees that the PMA shows that the government is serious about addressing cost and performance management needs in reform and decision making.<sup>94</sup> By moving federal agencies toward a scorecard rating of green, much needed financial performance goals will be met.

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<sup>90</sup> Executive Office of the President, Federal Financial Management Report 2004, 6-7.

<sup>91</sup> Sarah Michael, "Agencies Find Greener Pastures," *Federal Computer Week* 18 no. 24 (19 July 2004): 8.

<sup>92</sup> Timothy Clark, ed. "Grades Are In," *Government Executive* 36 no. 12 (15 July 2004): 6.

<sup>93</sup> Jonathan Breul, "President's Management Agenda: What Comes Next?" *The Business of Government* (Spring 2005): 58-59.

<sup>94</sup> Irwin T. David, "Financial Information for Program, Policy, and Operating Officials," *The Journal of Government Financial Management* 51 no. 1 (Spring 2002): 14.

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## **IV. FINANCIAL SYSTEM ANALYSIS**

### **A. OBJECTIVES**

The objective of the financial systems analysis is to compare audited financial statement indicators with the PMA Scorecard and GAO High Risk Series. Through a comparison of interrelationships between the systems it will identify signal markers for agency success on the PMA Scorecard, the current administration's final measure of financial reform success.

The analysis begins with a look at audited financial statements and PMA Scorecard as independent systems over time. Two objectives are created in this analysis. The first is to determine if sustained success on audit financial statement opinions is attainable, and if so, is it the norm. The second is to look at what impact PMA progress ratings have on the overall scorecard result, if any.

Relationship analysis of the financial systems will look at the impact of audited financial statement opinions on PMA Scorecard success, and the influence of the GAO High Risk Series on both systems. By comparing audit opinion success to PMA Scorecard results, we hope to see a relationship between the length of sustained unqualified opinions and scorecard success. The relationship will also help to identify those agencies who have exhibited the greatest success, in hopes of providing a benchmark for other agencies. The GAO comparison is designed to discover if evidence exists to suggest that the GAO High Risk Series identification results in improved financial success.

### **B. METHODOLOGY**

Raw data on three financial systems has been previously summarized. For audited financial systems and PMA Scorecard, the data can be viewed as ordinal. In other words, the results are in order – Green is better than yellow which is better than red; Unqualified is better than qualified which is better than disclaimer. However, there is no specific, meaningful, or consistent data that comes from measuring interval between the data. Data for the GAO High Risk

Series is used strictly as a comparison over time. Information is provided as to the addition and removal of agencies from the list and this is used to compare potential relationships with the audited financial statement opinions and PMA Scorecard results.

While the Department of Homeland Security (DHS) and Federal Emergency Management Agency (FEMA) have had, or are required to have, PMA Scorecard reports, they have been removed for purposes of comparisons. Agency consolidations that took place after 9/11 have removed FEMA from scored agencies in place of DHS. To get a similar look at agencies across time and for comparison between PMA Scorecard and audited financial statements, they have been removed. In addition, for comparisons between PMA Scorecard and Audited Financial Statements, the Nuclear Regulatory Commission has also been removed. They are not a scorecard-graded agency and thus comparisons are not possible. This effectively results in a comparison of 22 federal agencies.

### **C. TRENDS WITHIN SYSTEMS**

#### **1. Audited Financial Statement Sustained Success**

All CFO Act agencies, with the exception of the Department of Defense, have achieved two or more years of unqualified audit opinions. However, not all agencies have been able to sustain this success in consecutive years. As a basis for system comparison, one would expect sustained audit opinion success (a measure of accountability and reliability) would be a significant factor in achieving the goals of PMA. A look at agency sustainment of financial statement audit opinions is provided.

Yearly agency financial statement audit opinions are provided in Table 1. As we compare the 21 agencies (DoD is the exception) that have received an unqualified opinion, we see that a majority of those agencies have been able to sustain the success. 67% of federal agencies, once they have obtained an unqualified opinion, have sustained it for the remaining years. Three agencies, the Department of the Interior (DOI), Department of Transportation (DOT), and Department of Education received a one year qualified opinion and immediately

went back up to an unqualified opinion. If we include these three agencies, 81% of agencies have been able to gain and sustain financial statement success.

Sustained Opinions	Agencies with at least one unqualified opinion	Agencies Sustaining Opinions	Percent Sustainment
Sustained Unqualified	21	14	67%
Sustained With One Qualified	21	17	81%

Table 4. Audit Opinion Sustainment

Four (five if you include DoD, which has never achieved anything but a disclaimer) agencies have all shown problems in sustaining audit success year in and year out – Department of Justice (DOJ), Department of Housing and Urban Development (HUD), National Aeronautics and Space Administration (NASA), and Small Business Administration (SBA). Brook’s studies in 2001 compare success factors of those organizations that have achieved and sustained success.<sup>95</sup> It would be interesting to compare these factors with the five agencies that are currently failing to sustain opinions. Some factors affecting agency audited financial statement opinion success might be demographic or size/complexity issues. It could provide further insight into the success factors presented in the study and provide potential focus points for those agencies in sustaining success.

Sustainment of unqualified audit opinions is an indicator of timely and reliable financial statement data. It is likely that those agencies that have garnered an unqualified opinion have stable financial systems and practices.

<sup>95</sup> Brook, Refs. *Audited Financial Statements: Getting and Sustaining Clean Opinions* and Douglas A. Brook, “Business-Style Financial Statements Under the CFO Act: An Examination of Audit Opinions” (Ph.D. diss, George Mason University, Fairfax, 2001): 32.”

Once these systems and practices are in place, it should be easier to sustain successful audit results. The data supports the assertion that once an opinion is earned, it is sustained. These high standards set the basis of using sustained audit opinion success as a factor in determining their relationship to results success on the PMA Scorecard.

## 2. PMA Progress Rating to PMA Results

Scorecard ratings are the end measure of an agency's ability to meet the financial management standards as outlined in the PMA. During the development of the scorecard, progress ratings were also added to show agency progress toward achieving financial standards. Based on their intended purpose, we would expect progress ratings to signal attainment of overall scorecard success. A look at those ratings as provided in Tables 2 and 3. The data, at this point, is inconclusive.

Years of Green Progress Rating	Number of Agencies with Progress Greens	Number of those Agencies with Scorecard Greens	Percent Green Scorecard Rating
One	21	8	38%
Two	19	8	42%
Three	17	8	47%
Four	10	5	50%

Table 5. Progress Ratings to Scorecard Results

Only five of ten agencies (50%) which have had green progress ratings for four continuous years achieved an overall scorecard rating of green. This percent falls slightly to 47% if we expand the analysis to those agencies which have had a green progress rating for three or more years. The data is not significant in establishing a relationship between implementation progress and scorecard ratings. This data is reasonable if we assume that each agency has differing timelines for reform implementation. For example, large agencies would

take longer to reform than small agencies. Further research into individual agencies is needed to determine if this is the case.

About the only thing we can conclude from this analysis is that the average time horizon for improvement to a green scorecard result is somewhere greater than 4 years of successful progress. The data concludes that while progress ratings are an indicator of agency reform implementation with respect to the standards, they do not necessarily signal a timeline for success.

#### **D. INTERRELATIONSHIPS BETWEEN SYSTEMS**

##### **1. Overall PMA Scorecard to Audited Financial Statements**

To provide an overall starting picture of agency comparisons, a status of the current ratings is provided. Based on Table 4, we see that in all cases and for all agencies, a scorecard rating is not given anything above a red unless the agency has garnered an unqualified opinion on the financial statements. This is in line with PMA performance standards. We also see that agency scorecard performance is, in fact, made up of more than just an unqualified opinion. Numerous agencies have received and held an unqualified opinion for years but have not yet obtained a green on the scorecard. Is there a specific characteristic amongst those agencies who have received green on both financial statements and scorecard?

We know from the PMA Scorecard standards that an agency cannot receive a green rating until they implement 'results' driven activities with their financial information. The next analysis attempts a further look into agency characteristics and length of audited statement success to see if they are good predictors of PMA Scorecard success.

Agency	2004 AFS	PMA Scorecard	PMA Progress
DOC	U	G	G
DOD	D	R	R
DOE	U	G	Y
DOI	U	R	Y
DOJ	D	R	Y
DOL	U	G	G
DOT	U	R	G
EDUCATION	U	G	G
EPA	U	G	G
GSA	U	Y	G
HHS	U	R	G
HUD	D	R	G
NASA	D	R	Y
NSF	U	G	G
OPM	U	R	G
SBA	Q	R	G
SSA	U	G	G
STATE	U	G	G
TREASURY	U	R	Y
USAID	U	R	G
USDA	U	R	G
VA	U	R	Y

Table 6. Current Status of Measures

Source: Author created from 2004 Financial Report of the U.S. Government and The Presidents Management Agenda: the Scorecard [web page]

## 2. Time Phased Comparisons of PMA Scorecard to Audited Financial Statements

The first step in this comparison of audited financial statements to the PMA Scorecard is look at the results of the first four years of each system. Figure 3 presents a graphical representation of results for both systems. The chart is divided up by year groups, with similar years of each system matched together. In Figure 3, Year 1 represents financial statement results of 1996 and scorecard results of 2002. Within each year group, a one represents either a scoring of red or a disclaimer of opinion, based on system. Similarly, a two represents either a yellow on the PMA Scorecard or a qualified opinion on audited financial statements, and a three represents a green on the PMA Scorecard or an unqualified audit opinion.

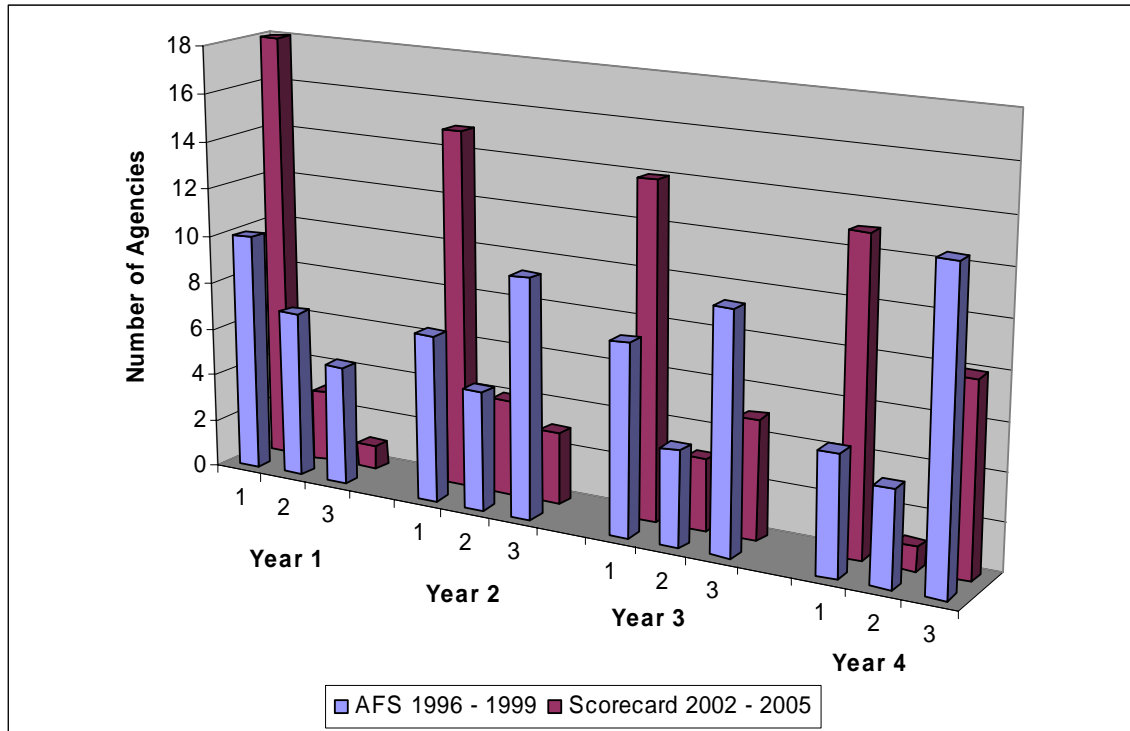


Figure 3. Comparison of Results for First Four Years

While both exhibit a general trend of improvement (as measured from a one to three), we see that more agencies started out with successful audited financial statement results. There are several possibilities for this result. The most plausible revolves around the pre-measurement starting point for each system. It is well known that while only a few agencies were required to comply with the CFO Act requirement for financial statements in 1990, this legislation did signal the potential for its expansion to all agencies. Many agencies had already begun leaning toward meeting this objective prior to the requirement. In fact, Gross reports that almost 118 federal entities had begun producing financial statements by 1994<sup>96</sup>. An additional factor for the perceived head-start on successful audited financial statement opinions relates to the timing of the GMRA. The GMRA, which expanded the CFO Act requirements to the 24 federal agencies, was signed into law in the beginning of fiscal year 2005.

<sup>96</sup> Gross, 28.

However, it did not mandate compliance until fiscal year 2006 statements, effectively giving federal agencies one extra year to work out compliance issues.

We can better normalize our comparison by eliminating the first year of the PMA scores, effectively comparing year two of PMA compliance to what amounts to year two in preparation of audited financial statements. This representation is presented in Figure 4. We see that the curves are more similar and exhibit similar upward success trends. This representation, while telling, still has some comparison problems. Most striking is the much larger percent of scorecard ratings that are red when compared to the similar population of audited financial statement opinions.

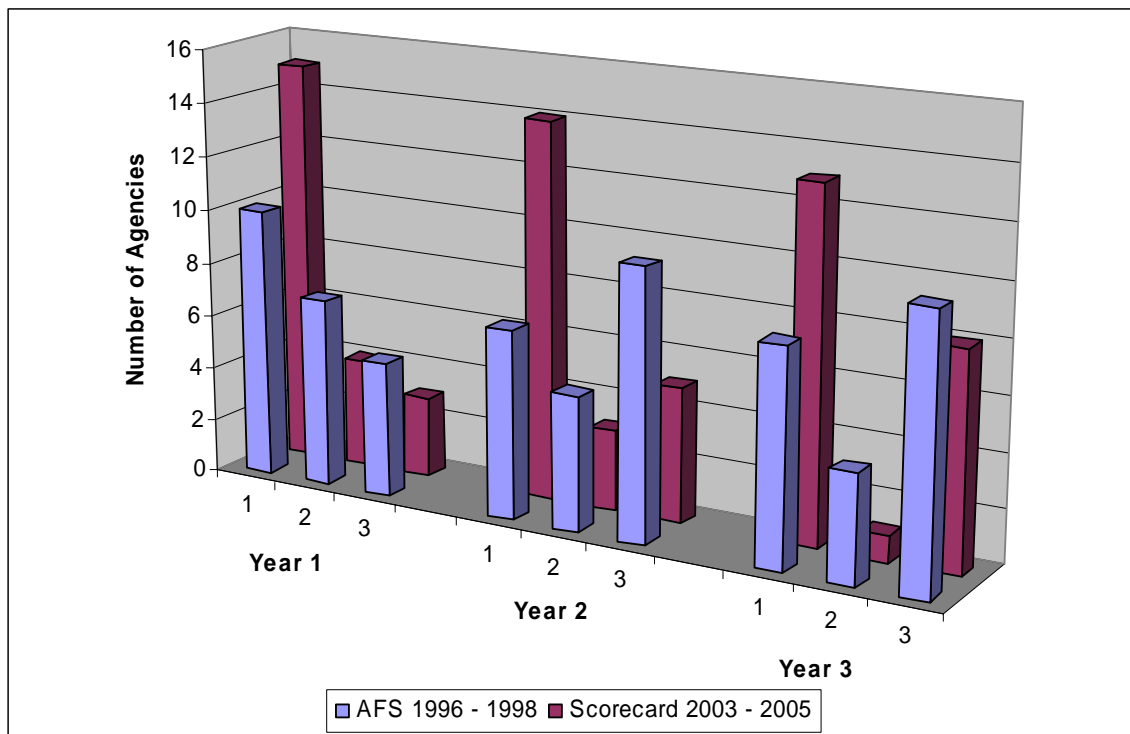


Figure 4. Comparison Normalized for Starting Year

Another way to compare while removing the potential starting bias is to look at the percentage of improvement each year. This removes a look at overall agency success totals with a focus on how agencies improved within those years. Table 7 summarizes the percent improvement in successful ratings for



the first four years of each system. The improvement data provides an interesting comparison with the overall trends provided above.

In the above comparisons of agencies in year one, six had achieved unqualified opinions while only one agency had received a green on the scorecard. In comparison, by year four, 14 agencies had achieved an unqualified opinion while eight organizations had achieved a green on the scorecard. While those statistics would make it appear that agencies showed greater audit opinion improvement over time, in fact, the results are much closer. After four years both agencies exhibited a similar improvement rate. This improvement rate shows that agency ability to improve over time is about equal between both systems.

Percent Improvement in Green Success	Audited Financial Statements	PMA Scorecard
Year 1 to Year 2	23%	9%
Year 2 to Year 3	0%	9%
Year 3 to Year 4	14%	14%
Total Improvement, Years 1 to 4	36%	32%

Table 7. Scorecard and Audited Financial Statement Improvements

### 3. Audited Financial Statement Trends to PMA Scorecard Success

Do agencies with a longer track record of audited financial statement success also find PMA Scorecard success easier? Of those agencies who have newly obtained unqualified opinions (those with three or less years of unqualified opinions), none has received a green or yellow scorecard rating. Conversely, of those agencies with five years or more of continued unqualified audit opinions, 54% have achieved a green PMA Scorecard rating. This is

compared to just 11% (only one of nine) of those agencies without a lengthy record (five or more years) of financial statement success.

The numbers are even more striking when we look at sustained success in financial statement preparation. Of those agencies with over seven years of unqualified audit opinions, 80% have achieved a PMA Scorecard rating of green. This suggests that those agencies with a track record of financial accountability are better prepared to meet performance and results goals. This makes intuitive sense. An agency will only be able to achieve results if it can first be assured of solid, dependable financial data. Reliable and timely information is the foundation for which agencies can then manage for results.

Eight total agencies have achieved a scorecard rating of green. Four agencies with a seven year track record of unqualified opinions have scored a green on the scorecard. Of the other four agencies, three have also experienced a long record of unqualified opinions. Those three have only failed to garner an unqualified opinion in one year out of their last eight, and in all cases it was a qualified opinion. This shows that almost all (88%) of agencies with a track record of unqualified financial statement opinions are more apt to succeed under the PMA Scorecard financial management initiative. The lone exception to this is the Department of Education, which we will discuss in further analysis.

Years of Sustained AFS Success	Number of Agencies with Unqualified Opinions	Number of Agencies Scorecard Greens (8 total)	Percent Green
Less than 3	17	8	47%
3 years or more	16	8	50%
5 years or more	13	7	54%
Over 7	5	4	80%
Over 7 and one qualified opinion	8	7	88%

Table 8. Length of Audited Financial Statement Success to Scorecard

A further comparison of the eight agencies that have achieved a green scorecard rating is used to estimate the average amount of years between sustained unqualified audit opinions and PMA Scorecard green. On average, it takes 5.25 years of unqualified opinions before an agency achieves a green 'results' rating on the scorecard. However, with a range of 6 years and a standard deviation of 2.12 years, the statistic is hardly telling. While the average number of years provides only an interesting statistic, the bottom line is that lengthy, consecutive unqualified opinions are a valuable signaling indicator.

#### 4. Successful Agencies across Financial Measurement Systems

So which agencies are the examples that should be looked at for success? Reviewing yearly financial data of all agencies, we are able to complete this simplest of comparisons. We can readily identify those specific agencies that exhibit a high degree of financial success within the existing financial measurement framework.

Beginning with yearly results for the PMA Scorecard, we see that three agencies have achieved fully successful result of green for three or more years.

These agencies are the Environmental Protection Agency (EPA), the National Science Foundation (NSF) and the Social Security Administration (SSA). All three of these agencies also demonstrate a long track record of unqualified audit opinions. These agencies could be thought of as benchmarks for financial accountability and performance success. However, the ease of success might be precisely what makes another organization a better study case on how to achieve financial reform.

Unlike the three previous agencies, the Department of Education has a checkered history of financial success. The Department of Education's first six years of audited financial statements resulted in two disclaimers, three qualified statements, and only one unqualified. However, with the exception of 1997, they showed improvement in opinions in every year until their eventual sustained unqualified opinion from 2002 on. Their scorecard results are similar, with a red in the first two years and a green from 2004 on. This ability to turn around financial accountability and performance positions might make for a good case study on the steps it takes to correct financial deficiencies in a federal agency, potentially helping to identify key financial reforms and lay a roadmap to success.

## **5. GAO High Risk List to PMA Scorecard and Audited Financial Statements**

A link between the PMA Scorecard and the GAO High Risk List is evidenced from the initial development of the PMA. The initial executive branch report on the PMA alludes to the influence of the GAO in its development of the scorecard: "The need for reform is urgent. The General Accounting Office (GAO) "high-risk" list identifies areas throughout the federal government that are most vulnerable to fraud, waste, and abuse. Ten years ago, the GAO found eight such areas. Today it lists 22."<sup>97</sup>

Among those agencies identified on the high risk list, is there evidence in the data to suggest that agencies have improved financial accountability and

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<sup>97</sup> Executive Office of the President, Office of Management and Budget, *The President's Management Agenda* (Washington D.C.: Government Printing Office, 2001): 2.

performance as a result of being identified? Or at the very least, has the GAO recognized gains as shown through the positive scorecard and audited financial statements ratings on its evaluation of those agencies with financial management risk? This relationship can be determined by looking individually at those agencies which have been (or still are) on the high risk list over time, and compared directly to the PMA Scorecard and audited financial statements over the same time.

Agency information is presented in Figure 5. Audited Financial Statement Data is presented as Disclaimer of Opinion (D), Qualified Opinion (Q), and Unqualified Opinion (U). PMA Scorecard Data is shown according to standard stoplight criteria: Red (R), Yellow (Y), Green (G). GAO High Risk Data is presented as an arrow which shows the length of time on the High Risk List. A line that stops with a circle represents the date it was removed; an arrow represents an agency that is still on the list.

Upon initial review, there does not appear to be much of a connection between GAO recommendations and audited financial statement or scorecard results. Of the five agencies that have been recognized by GAO for having a high risk in financial management, only two organizations are still on the list. The Customs Service (then a part of the Department of Treasury) was removed in 1999 while the Forest Service and Federal Aviation Authority (FAA) were removed recently in 2005.

While there is no quantifiable link between audited financial statements and the GAO list, sustained unqualified opinions do appear to be a signaling indicator of removal from the high risk list. GAO reports provide a summary of the reasons that an agency was removed from the list. The Customs Service was removed in 1999 after it received two years of clean audit opinions and showed improvement in other areas.<sup>98</sup> The Forest Service and FAA were removed for similar reasons including success in meeting clean financial

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<sup>98</sup> Stephen Barr, "Tasks Sliced Many Ways," *Washington Post* 26 January 1999.

statements and continued improvements in other financial management areas.<sup>99</sup> This would, at first, lend one to believe there is a close tie between audited financial statements and the high risk list. It is important to note though, that in all cases GAO did not remove the agency from the high risk list until it demonstrated sustained improvement. In this case, an unqualified opinion on audited financial statements would be a leading indicator of removal from the GAO High Risk Series.

While the data may be inconclusive at this point, this does not say that agency identification on the list has no value. The value is inherently shown; of the five agencies that have been identified, three have been removed from the list. Apparently, the increased notoriety and advice supplied in the GAO report provides valuable motivation for an agency to reform its financial management systems.

Other than concluding that GAO can pick agencies with a poor record of financial management performance, there appears to be no relationship between the GAO High Risk List and the PMA Scorecard. It may be too early to say for sure though. All agencies listed on the GAO High Risk Series have yet to obtain a yellow or green rating scorecard rating. However, two agencies have been recently removed from the GAO list. It would be valuable to check within a year or two to see if there is any correlation between removal of these two agencies and scorecard success.

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<sup>99</sup> U.S. Governmental Accountability Office, *High Risk Series: An Update* (Washington, D.C.: USGAO, 2005), 11,13.

Department of Defense	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Audited Financial Statements	D	D	D	D	D	D	D	D	D	
PMA Scorecard Results							R	R	R	R
PMA Scorecard Progress							G	G	Y	R
GAO High Risk										

US Department of Agriculture	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Audited Financial Statements	D	D	D	D	D	D	U	U	U	
PMA Scorecard Results							R	R	R	R
PMA Scorecard Progress							G	G	G	G
GAO High Risk										

Department of Transportation	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Audited Financial Statements	D	D	D	U	Q	U	U	U	U	
PMA Scorecard Results							R	R	R	R
PMA Scorecard Progress							G	G	G	G
GAO High Risk										

Department of Treasury	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Audited Financial Statements	D	Q	Q	Q	U	U	U	U	U	
PMA Scorecard Results							R	R	R	R
PMA Scorecard Progress							G	Y	Y	Y
GAO High Risk										

Figure 5. GAO Comparison

Source: Author created from 2004 Financial Report of the U.S. Government, and The Presidents Management Agenda: the Scorecard [web page], and U.S. GAO, High Risk Series

## E. SUMMARY ANALYSIS OF RELATIONSHIPS

The analysis of the individual systems reveals a few conclusions. The first notable conclusions deal with the analysis of financial systems. Sustainment of results, whether it is in sports, business, or any other activity, is a mark of achievement. As such, in reviewing audited financial statement unqualified opinions, it has become evident that in most cases, an agency that first attains an unqualified opinion will most likely keep that opinion in the future. This is a testament to the development of systems and procedures that have been modified to achieve such results. It is prime support for the worth of legislative and executive financial reforms of over the past 15 years.

Sustainable financial statement achievement is a starting point for comparison between audited financial statements and PMA Scorecard. Based on an analysis between audited financial statements and the scorecard, it is apparent that continuous unqualified audit opinions signal scorecard rating success. This is attributed to a number of factors, included standardized

financial systems, reliable and accurate financial data, and an understanding of agency operations that come with years of financial improvement.

Another interesting relationship is how agencies appear to improve within a system at similar rates. Within the four years, agency improvement was measured at almost the same rate within both systems. Only time will tell if this relationship holds up over the next few years with the scorecard results, but it is quite plausible. As agencies are required to meet certain objectives or standards, they are likely to conform to these standards over time.

One of the more important results that the analysis points to is the existence of benchmark agencies for achieving success under the current systems. The EPA, NSF, and SSA have exhibited a strong track record of success within these measures. The Department of Education is notable in that, in both audit opinions and scorecard ratings, they fought through poor scores to excellent results by making the necessary changes within its organization.

The GAO High Risk List, while a vital part of government auditing and evaluation function, likely has little direct relationship on financial statements or scorecard success. While the report and list provide valuable insight and support challenged agencies, there is no discernable link between the GAO reports and rankings on either audited financial statements or the PMA Scorecard. Unfortunately, while there is no direct correlation between the GAO High Risk Series and the scorecard, again, this should not understate its importance in providing and sustaining financial improvement. A “watchdog” function is always necessary.



### **SUMMARY RESULTS**

- Audited financial statement success, once obtained, is sustained
  - 81 % of agencies have sustained success
- Agencies exhibit standard rates of improvement within systems over time
  - Over first three years, systems averaged 34% improvement
- Length of audited financial statement success signals PMA Scorecard rating success
  - 88% of agencies with over seven years of audited statement success have scored green on scorecard
- Four agencies: EPA, NSF, SSA, and Dept of Education provide best benchmark organizations for success
- Impact of PMA progress ratings on scorecard results is inconclusive
- GAO High Risk List has little direct correlation to financial statement or scorecard success.

Figure 6. Summary Analysis of Results

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## **V. SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS FOR FURTHER STUDY**

### **A. SUMMARY**

Existing literature and research on federal financial reform emphasizes a government in the midst of great change. Financial reform was begun in earnest in the early 1990s and continues today. As the guiding legislation of reform, the CFO Act established the need for reliable and accurate financial data across federal agencies. It defined CFO responsibilities within agencies and promoted the value and importance of improved government financial management. Reform was continued with the GPRA and requirement for performance of results based financial management. Agencies continue to face great challenges in reforming antiquated financial systems and practices, but for the most part, agencies have embraced the change and exhibit proficiency in financial management accountability and performance.

The three systems analyzed – GAO High Risk List, Audited Financial Statements, and the President’s Management Agenda Scorecard – demonstrate that these reforms have not just been glossed over, but are give much needed attention. Each management system has provided great improvements to the financial health of the federal government. Improvement of financial management systems and information support to decision makers has vastly improved with reforms over the past 15 years. The systems demonstrate that the executive branch and federal agencies have a renewed focus on the betterment of financial management and as stewards of public funds.

### **B. CONCLUSIONS**

While the three systems are all designed with the idea of reforming financial management, they have come about it in distinctly different ways. Common financial statements, certified by audit, are intended to convey timely, reliable, and accurate financial information to whomever needs it. The GAO High Risk Series provides audit and evaluation services with a focus not only on the

problem, but the solution. While not a comprehensive financial measurement system in the same vein as the other two, its individual focus on serious agency problems provides valuable results in financial management improvement. The President's Management Agenda Scorecard is the latest motivator toward sound financial management. Its standards encompass important aspects of management and focus on the results-based performance goals that were the force behind the CFO Act, GPRA and other legislation.

Through the analysis, four agencies have been identified as benchmarks for financial achievement. Further studies of these four agencies could provide a valuable roadmap toward financial success for other agencies. The analysis should be undertaken with resolve to determine those financial practices and automated information systems that support the attainment of unqualified opinions and scorecard success.

Evidence of system overlap is readily apparent between the three systems. While the GAO High Risk Series seems to be based on a "by-exception" format, its arguments are apparent in the design of the PMA Scorecard. Audited financial statements are a crucial building block in obtaining minimum sufficient or 'compliance' standards in the PMA Scorecard. The scorecard can be seen as the ultimate attainment of financial success, at least according to the current administration. Despite this, all three measures assume a crucial role in the evolution of federal agency financial reform.

Toward this end, we have identified trends with which audited financial statements signal scorecard success. As the length of sustained financial statement accountability increases (as measured by unqualified audit opinions), the probability of obtaining fully successful performance standards, as measured by scorecard green, increases dramatically. Additionally, there is evidence to expect scorecard improvement at a rate similar to audited financial statements.

Extrapolating from audit financial statement improvement rates, we can predict agency success on the PMA Scorecard. Based on this analysis, we

should expect to see a 13% improvement or 3 more agencies obtaining a green financial scorecard rating over the next year. Projecting further forward, we should see 82% of the agencies obtaining results-based financial management by 2008. Whether these improvements hold true to form or not is to be seen. What is for sure is that any increase in the use of performance-based financial management in the federal government is valuable.

It becomes apparent in the analysis that a strong record of accountability and control is a necessity for financial performance. It is clear from legislative mandates in the CFO Act and GPRA along with current executive branch directives that results-based financial performance is a focus of federal agency management. Findings show that the length of unqualified audit opinion is a factor in PMA Scorecard and results-based financial success. Financial statement accountability, by definition is not the same as performance, but it is a required foundation for the results-based financial goals agency and congressional leaders strive for.

### **C. IMPLICATIONS FOR THE DEPARTMENT OF DEFENSE**

The Department of Defense exhibits perhaps the worst record of agency performance in all three financial measurement systems. Since the early reform requirements, DoD has struggled to transform its cumbersome and diverse management systems to an integrated and auditable program. Findings from this report show that an agency must first exhibit a history of successful financial statement audit success before results-based goals can be achieved. DoD has consistently failed to meet their objectives on obtaining a clean audit opinion as evidenced by the past 10 years of disclaimer opinions, the only federal agency with this distinction.

Based on data in this report, if we recognize the need for audit financial statement success first, positive improvement on either GAO High Risk Series or the PMA Scorecard is much further away. Unfortunately for the Department of Defense, improvement to audit opinion ratings is not expected to happen in the next couple of years. As recently as 2004, the GAO proffered that DoD would

not meet its most recent goal of auditable financial statements in 2007.<sup>100</sup> The study points to flawed management systems and a lack of effective oversight, accountability, and monitoring mechanisms, among other findings.<sup>101</sup> It is clear from findings that sustained audit results must first be obtained before the DoD can expect other financial performance-based improvements.

#### **D. RECOMMENDATIONS FOR FURTHER STUDY**

One of the major tenets of financial reform has been to provide reliable information for resource allocation and decision making. While this paper draws conclusions about the trends in financial management reform and the betterment of agencies in the defined systems, it does not show or support references to decisions based on this improved knowledge. One would hope to see a shift of resources or form of preferential treatment to those organizations with demonstrated fiscal and management controls. However, it appears on the surface at least, that political winds or world events continue to be the drivers of resource allocation. This is evidenced by the fact that despite possibly the worst record of financial management accountability and performance, the Department of Defense budget continues to grow. A recommendation along these lines would be to check for established links between those agencies that have ranked well in financial resource management and any government allocation decisions that may have resulted from this action. Additionally, as the FFMIA requires reporting on those agency officials who oversee failing systems, are those same officials actually punished or rewarded for their role in financial reform?

Financial reform is costly. While it is evident from past resource allocation mistakes that some form of agency reform was necessary, is the benefit of developing and annually preparing financial statements worth the cost? Millions of dollars have been spent and thousands of man-hours are exhausted every

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<sup>100</sup> U.S. Governmental Accountability Office, *Financial Management: Further Actions Are Needed to Establish Framework to Guide Audit Opinion and Business Management Improvement Efforts at DOD* (Washington, D.C.: USGAO, 2004), 3.

<sup>101</sup> Ibid, 1,4.

year in the creation of audited financial statements. In relating back to the previous question about statement value to decision makers, are audited financial statements and scorecard tracking the most cost beneficial method of attaining financial reform results? Or are other methods more practical?

Brook prepared extensive studies analyzing demographic and other information that are key success factors in unqualified audit opinion statements.<sup>102</sup> A valuable extension of this study would be to update while considering PMA Scorecard ratings and agencies. Do agency demographic factors play a role in scorecard performance ratings? Are agency success factors of audited financial statements the same as those in PMA Scorecard ratings? The determination that these success factors exist across agencies meeting multiple financial system objectives would support their value.

Case study work on those identified benchmark agencies would provide great value in developing an approach for successful scorecard rating attainment. There are many different avenues of research to be conducted in this area. The first would be to identify what results-based systems or practices agencies followed to obtain a green rating. Could these practices be transported from agency to agency as a model of success? If so, a framework for financial success could be developed and adopted by failing agencies to help lead them to financial reform achievement. Secondly, were these practices in place before development of the scorecard standards or have they been developed for the sole purpose of achieving that objective? One would hope that financial reform initiatives are undertaken with the sole objective of improved financial data quality and usefulness to decision makers. History tells us this is not always the case. At the very least, we would hope that agency reforms aligned with scorecard standards are oriented toward the most beneficial financial information and systems possible.

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<sup>102</sup> Brook, "Business-Style Financial Statements Under the CFO Act: An Examination of Audit Opinions."

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